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No. 832

In the Supreme Court of the United States

OCTOBER TERM, 1959

I. A. DRESS CO., INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 10a-29a)[1] are reported at 32 T.C. 93. The opinion of the Court of Appeals (Pet. 9a-12a) is reported at 273 F.2d 543.

JURISDICTION

The judgment of the Court of Appeals was entered on January 11, 1960. (Pet. 13a.) The petition

[1] "R" references are to the pages of the separately bound appendix to the taxpayer's brief in the Court of Appeals which has been filed as part of the record before this Court.

for a writ of certiorari was filed on April 4, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the record supports the trial court's findings that the corporate taxpayer accumulated its earnings and profits beyond the reasonable needs of its business and that the corporation was availed of during the taxable year for the purpose of preventing the imposition of surtax upon its sole shareholder.

STATUTES INVOLVED

Section 102 (a) and (c) of the Internal Revenue Code of 1939, and Section 534(a)(1) and (2), (b), (c) and (e) (1) and (2) of the Internal Revenue Code of 1954 are set out in the Appendix, *infra*, pp. 10-12.

STATEMENT

The facts as found by the Tax Court (R. 10a-18a), and as stated by the Court of Appeals (Pet. 10a-11a), may be summarized as follows:

The taxpayer is a corporation organized on October 18, 1924, under the laws of the State of New York. At all times here material, it has been engaged in the business of operating a commercial building under a lease. (R. 10a.) Its paid-in capital consisted of 50 shares of $100 par value common stock which was owned by its president and sole stockholder, Isaac Alper. (R. 10a.) The taxpayer's business activities

consisted solely of subletting space in its leased building, collecting rents, and furnishing all the services required of a landlord. The lease under which the taxpayer occupied the building in 1949 ran to January 31, 1964. In 1950, the lease was extended to January 31, 1967. The taxpayer's business prospered and, in 1949, its accumulated earnings and profits were $106,821.06. However, the taxpayer has never paid a dividend. The alleged reason for never having declared a dividend, for a period extending from 1924 through 1949, was that the taxpayer planned to buy the fee of the building it leases (Pet. 10a-11a); however, the plan was vague and indefinite as to the time of fruition, the amount of cash required, and the interim earnings expectations (Pet. 11a). During the period that it is alleged that it was necessary to accumulate all earnings and profits, substantial personal loans were made by the taxpayer to its sole shareholder. (R. 15a.) If the taxpayer's net income had been distributed to Alper in 1949, he would have had substantial additional surtax liability. (R. 15a.)

On February 24, 1956, the Commissioner notified the taxpayer that a statutory notice of deficiency, for the year 1949, was proposed pursuant to Section 102 of the 1939 Code. On March 19, 1956, the taxpayer submitted a statement to the Commissioner pursuant to Section 534 of the 1954 Code. On May 31, 1956, the Commissioner issued a statutory notice of deficiency for 1949, which included a determination of a deficiency based upon Section 102. (R. 15a-16a, 18a.)

The Tax Court found that the taxpayer's earnings and profits for 1949 were accumulated beyond the reasonable needs of its business, and that the corporation was availed of during 1949 for the purpose of preventing the imposition of surtax upon its sole stockholder. (R. 18a.) The Court of Appeals affirmed, holding that the Tax Court's finding were amply supported by the evidence. (Pet. 11a-12a.)

ARGUMENT

The purpose of Section 102 of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 10) is to compel a corporation to distribute its earnings and profits so that individual stockholders will become liable for tax on the dividends received. *Helvering* v. *Chicago Stock Yards Co.*, 318 U.S. 693, 699. Accordingly, subsection (a) of Section 102 (Appendix, *infra*, p. 10) imposes a surtax on a corporate taxpayer if one of its purposes for accumulating earnings and profits was to avoid the imposition of tax upon its shareholders. The taxpayer, as in the usual tax case, has the burden of disproving the Commissioner's findings. Indeed, subsection (c) of Section 102 (Appendix, *infra*, p. 10) provides that, if an accumulation is beyond the reasonable needs of the business, that fact increases the taxpayer's burden so that it must then disprove the proscribed purpose by a *clear* preponderance of the evidence. These are, of course, questions of fact, and the trial court's findings are not reversible unless clearly erroneous.[2]

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[2] *Helvering* v. *Chicago Stock Yards Co.*, 318 U.S. 693, 700; *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282, 295, rehearing

The Tax Court explicitly found that the taxpayer's earnings and profits for the year 1949 were accumulated beyond the reasonable needs of its business, and that this was done for the purpose of preventing the imposition of surtax upon Alper. (R. 18a.) The court below, after reviewing the evidence, held that there was ample record support for the Tax Court's findings and that they are not clearly erroneous. (Pet. 11a.) The concurrent findings of fact by the two courts below are entitled to finality here. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51; rehearing denied, 350 U. S. 943; *Comstock* v. *Group of Investors*, 335 U. S. 211, 214.

Some of the factors which support the findings below are:[3] that the taxpayer has never declared a dividend though it was successful and had accumulated $106,821.06 by the year 1949 (R. 29a; Pet. 11a); that Alper, the sole shareholder, was aware of the fact that if he distributed earnings of the taxpayer to himself he would have incurred a large additional

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denied, 305 U.S. 669; *Casey* v. *Commissioner*, 267 F.2d 26, 31 (C.A. 2d); *Kerr-Cochran, Inc.* v. *Commissioner*, 253 F.2d 121, 124 (C.A. 8th); *Latchis Theatres of Keene* v. *Commissioner*, 214 F.2d 834, 835 (C.A. 1st).

[3] See, for example: *Helvering* v. *Chicago Stock Yards Co.*, 318 U.S. 693, 700-701; *Kerr-Cochran, Inc.* v. *Commissioner*, 253 F.2d 121, 128 (C.A. 8th); *Pelton Steel Casting Co.* v. *Commissioner*, 251 F.2d 278, 280 (C.A. 7th), certiorari denied, 356 U.S. 958; *KOMA, Inc.* v. *Commissioner*, 189 F.2d 390, 396 (C.A. 10th); *Semagraph Co.* v. *Commissioner*, 152 F.2d 62, 65 (C.A. 4th); *Young Motor Co.* v. *Commissioner*, 32 T.C. 1336.

tax liability (Tr. 20);[4] that, as a result of taxpayer's never having declared a dividend, the liquid assets of the corporation increased from $5,000 to over $100,000 (see R. 10a, 13a); that, notwithstanding an alleged purpose to accumulate funds to purchase a building, Alper used the accumulated earnings for his own personal purposes (Tr. 30-31); that the accumulated funds were not, so far as the record shows, formally devoted to any specific purpose, so that the sole shareholder could use them for either the purchase of property or, as he did, for his own purposes (Tr. 30-31); and that the alleged plan for the purchase of a building remained vague and indefinite throughout the years. (Pet. 11a).

Taxpayer argues that the court below applied an erroneous test because it allegedly held that only the *immediate* needs of a taxpayer can be considered in determining the application of Section 102 (Pet. 14-18). But the Tax Court and the Court of Appeals both recognized that a taxpayer may accumulate earnings for future purchases or expansion. (R. 26a; Pet. 11a.) They held merely, in accordance with settled law, that a vague and indefinite plan for a future purchase of property will not avoid the surtax. *Bride* v. *Commissioner*, 224 F.2d 39, 41-42 (C.A. 8th), certiorari denied, 350 U.S. 883; *KOMA, Inc.* v. *Commissioner*, 189 F.2d 390, 395 (C.A. 10th); *Trico Products Corp.* v. *McGowan*, 67 F.Supp. 311, 320 (W.D.N.Y.), affirmed, 169 F.2d 343 (C.A. 2d), certi-

[4] Transcript references are to Appendix B of the Commissioner's brief filed in the court below, which has been filed as part of the record before this Court.

orari denied, 335 U.S. 899, rehearing denied, 335 U.S. 913; *Semagraph Co.* v. *Commissioner*, decided August 1, 1944 (1944 P-H T.C. Memorandum Decisions, par. 44,264), affirmed, 152 F.2d 62 (C.A. 4th).[5]

The taxpayer's reliance (Pet. 7-14) upon Section 534 of the Internal Revenue Code of 1954 (Appendix, *infra*, pp. 11-12) is unavailing. That section provides that under certain conditions the burden of proof is shifted to the Commissioner on the subsidiary unreasonable-accumulation issue. However, the Tax Court held (R. 24a-25a) that the taxpayer did not meet the conditions of Section 534. In any event, the court below decided (Pet. 12a) that, even if the burden of proof were shifted to the Commissioner, the

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[5] The taxpayer places great reliance on the substantive accumulated earnings provisions of the 1954 Code. (Pet. 7-8, 16-18; Of course, those provisions do not apply to this case since they do not apply to taxable years beginning before December 31, 1953, unless otherwise expressly provided. Section 7851(a)(1)(A) of the 1954 Code (26 U.S.C. 7851(a)). Nevertheless, it may be noted that even under the 1954 Code the taxpayer's vague and indefinite plan would not qualify. Section 537 of the 1954 Code (26 U.S.C. 537) in effect adopts the rule of the cases under the 1939 Code, which hold that anticipated needs of the business may be considered as reasonable needs *if* the plan of the taxpayer is definite and specific. Accordingly, in considering the enactment of that section, the Senate Finance Committee stated (S. Rep. No. 1622, 83d Cong., 2d Sess., p. 69 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4701)):

> It is contemplated that this amendment will cover the case where the taxpayer has *specific* and *definite* plans for acquisition of buildings or equipment for use in the business. It would not apply where the future plans are *vague* and *indefinite*, or where execution of the plans is postponed *indefinitely*. [Italics supplied.]

evidence is such that it would have to hold that the Commissioner satisfied that burden.

The taxpayer likewise urges (Pet. 13, 20) that the court below did not properly perform its function as a reviewing court. As previously noted, the questions here are factual, and therefore the Court of Appeals properly reviewed the trial court's findings in accordance with the "clearly erroneous" rule. Section 7482 (a) of the 1954 Code (26 U.S.C. 7482(a)); Rule 52 (a), Federal Rules of Civil Procedure.

The taxpayer's contention (Pet. 20, 22) that the courts below disregarded testimony of witnesses as to the purpose for its accumulation of income ignores the fact that the findings were based upon statements made by its own witnesses and on its own records. Indeed, there was no testimony that the purpose proscribed by Section 102(a) of the 1939 Code was *not* one of the taxpayer's purposes. Moreover, even if such testimony did exist, this Court has twice decided that the courts are not required to accept the testimony of a taxpayer's witnesses with respect to the purpose of the accumulation. *Helvering* v. *Chicago Stock Yards Co.*, 318 U.S. 693, 701; *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282, 295, rehearing denied, 305 U. S. 669.

The taxpayer's contentions (Pet. 20-21) as to the Tax Court's function in relation to administrative determinations were not presented below. However, we note that the taxpayer's reliance (Pet. 20-21) upon Section 10(e) of the Administrative Procedure Act, c. 324, 60 Stat. 237 (5 U.S.C. 1009(e)), is misplaced. That section has no application to the

Tax Court since it is not a "reviewing court" within the meaning of Section 10(e) of the Administrative Procedure Act, but is a court in which the facts are tried *de novo*, and the burden is upon the taxpayer to come forth with evidence that will convince the trial judge that his position is correct. *O'Dwyer* v. *Commissioner*, 266 F.2d 575, 580 (C.A. 4th), certiorari denied, 361 U.S. 862; *Cohen* v. *Commissioner*, 176 F.2d 394, 396 (C.A. 10th); *Kennedy Name Plate Co.* v. *Commissioner*, 170 F.2d 196, 198 (C.A. 9th).

CONCLUSION

The decision below turns on factual issues and there is no occasion for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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MAY, 1960.

APPENDIX

Internal Revenue Code of 1939:

SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

(a) [As amended by Sec. 103(d), Revenue Act of 1941, c. 412, 55 Stat. 687] *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

38½ per centum of the undistributed section 102 net income in excess of $100,000.

* * * * *

(c) *Evidence Determinative of Purpose.*—The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary.

* * * * *

(26 U.S.C. 1952 ed., Sec. 102.)

Internal Revenue Code of 1954:

SEC. 534. BURDEN OF PROOF.

(a) *General Rule.*—In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) [As amended by Sec. 5 of the Act of August 11, 1955, c. 805, 69 Stat. 689] *Notification by Secretary.*—Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531. In the case of a notice of deficiency to which subsection (e)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) *Statement by Taxpayer.*—Within such time (but not less than 30 days) after the mail-

ing of the notification described in subsection (b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

* * * *

(e) [As amended by Sec. 4 of the Act of August 11, 1955, *supra*] *Application of Section.*—

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.

(26 U.S.C. 534.)

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